

June 12, 1996

Mr. William F. Caton, Acting Secretary Federal Communications Commission Room 222 1919 M Street, NW Washington, D.C. 20554 JUN 1 2 1996 FCC MAY COOM

DOCKET FILE COPY ORIGINAL

Re: In the Matter of: Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services: CC Docket No. 96-112

Dear Mr. Caton,

Enclosed herewith are the original and twelve (12) copies of GVNW, Inc/Management's Reply Comments in the above-captioned matter. Please acknowledge receipt by affixing an appropriate notation on the copy of the GVNW Comments furnished for such purpose and return in stamped addressed envelope provided.

Yours truly,

Robert C. Caprye <sup>0</sup> / Consulting Manager

GVNW, Inc/Management

cc: Ernestine Creech, Accounting and Audits Division ITS

No. of Copies rooks OOT

JUN 1 2 1996 FCC MAN DOOM

# Before the FEDERAL COMMUNICATIONS COMMISSION Washington, D.C. 20554

	)	
In the Matter of	}	
	)	
Allocation of Costs Associated with Local	)	CC Docket 96-112
Exchange Carrier Provision of Video	)	
Programming Services	)	
	)	
	)	

## REPLY COMMENTS OF GVNW, INC./MANAGEMENT

#### I - INTRODUCTION

GVNW, Inc./Management respectfully submits its reply comments in the above captioned proceeding in response to comments filed in the FCC Notice of Proposed Rulemaking for Docket 96-112 (NPRM)<sup>1</sup>. GVNW is a consulting firm representing small independent local exchange carriers from a number of states.

In the NPRM, the FCC articulated the basic goals of this docket. The rules emerging from this docket must facilitate competition, lay the ground rules for LEC entry in CATV, and ensure that ratepayers rates are just and reasonable.<sup>2</sup> We support the basic goals as discussed in the NPRM and believe that they can be optimized through careful use of the regulatory process and adjustments to current cost allocation mechanisms. The incentive to cross-subsidize will likely change as competition takes hold in various markets. The current Part 64 rules can be retained in large part with certain adjustments to reflect new nonregulated telecommunications activities.

<sup>2</sup> NPRM at p. 11

<sup>&</sup>lt;sup>1</sup> Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services, CC Docket 96-112, FCC no. 96-214, released May 10, 1996.

These adjustments must serve to enhance the effectiveness of the cost allocation rules while not impeding the development of competition in all parts of the industry for the various industry participants. In the process of ensuring proper costing allocations, the FCC must be careful to create a system that results in decision-making that makes economic sense

#### II - FIXED ALLOCATION FACTORS

The NPRM's and cable industry proposal to create and maintain fixed allocation factors for assigning cost fail to meet the three basic goals of the docket. Competition will be stifled under such a plan as certain LECs will not make the economic decision to enter nonregulated markets if the cost allocation system is weighted heavily toward nonregulated services. Under fixed allocation, the factors utilized can not possibly represent the diversity inherent in the industry especially small rural companies. The fixed allocation approach will lack incentive for certain companies for investing in facilities to provide nonregulated services. Universal service, while not harmed perhaps by the fixed allocation system, will not be benefited as a result of fixed allocations.

## A. Fixed allocation factor proposals are inappropriate

The National Cable Television Association's proposal for fixed allocation factors are an attempt to place such a heavy burden of cost recovery on the nonregulated side of a LEC's business that it would impair the LECs ability to compete. Cable companies do not have similar cost allocation rules when providing telephone service over existing facilities. The high fixed factor allocations to nonregulated services will result in LECs being unable to compete with incumbent cable providers on the basis of price. The costs shifted to nonregulated services will drive down regulated revenue requirements. Small and rural LECs ability to provide universal service could be jeopardized as a result.

For example, a small LEC, which for sound business reasons, goes into the video business by making some facility investment could be caught in the squeeze caused by excessive cost allocations making CATV prices artificially high and the reduction in regulated loop costs which would lead to lower revenues from regulated services. Fixed factor allocators, more than the current Part 64 rules, would create anomalies caused by the various individual company

characteristics and circumstances. Fixed factor allocators, instead of providing a fair cost allocation means for LEC entry into CATV, will cause LECs to avoid moving into it.

The real effect of these cost allocation rules must be considered. Without realistic allocation rules, improper investment signals will be given to LECs as well as competing cable providers. The promotion of competition will be stifled and facilities/services deployment may be slowed.

An incumbent LECs' ability to package services, deploy technology efficiently, and compete in the new developing markets caused by the convergence of industries should not be discouraged by the rule changes emerging from this docket. Cost allocation rules must pass a litmus test of reasonability. Individual circumstances of LECs, especially smaller or rural LECs, account for the broad spectrum of reasonable cost allocations ranging from costs which are incidental to telephony to situations where nonregulated costs account for a large percentage of the combined business. A "One size fits all" regulatory treatment cannot handle fairly and correctly the diversity that exists in the industry.

### B - Existing Part 64 rules have achieved reasonable results.

Part 64 rules have been in place for almost a decade. In that period of time, particularly for small LECs, new technology, services and lines of business decisions have been made incorporating and considering the impacts of Part 64. Individual company service and market characteristics are considered in the Part 64 cost allocation process - the results of which over time have been reasonable.

Part 64, in addition to price cap rules, have operated to the benefit of the ratepayer since its inception. Types of costs incurred have not been substantially affected by any new industry development. Simply stated, overheads exist, and the allocation of such costs, though intended to reflect scientific precision, is at its root arbitrary. Proponents of the fixed allocation approach appear to place a great deal emphasis on the simplicity of their approach. Reasonability and appropriate reflection of real market conditions cannot be ignored in this rulemaking. Fixed allocators simply will not offer the desired flexibility for cost allocations for all LECs.

The administrative ease which NCTA argues for<sup>3</sup> in its proposal will be offset by the difficulty in maintaining the definitions of "baseline costs, stand-alone costs, and integrated networks". The baseline will, or should change over time. The process of updating the model will, at best, be cumbersome. Any regulated system for directing cost allocation is laden with difficult issues. NCTA's argument that simply because their proposal sounds easy to implement should be considered in light of all the individual circumstances which should affect the development of the fixed allocator.

#### C - Incentive to cross-subsidize will diminish with competition.

When regulation gives way to competition in telephony, the issue of cross-subsidization by LECs becomes moot. With local exchange competition developing for telephone and video, the incentive to cross-subsidize is reduced. It is reduced due to competition. As the new legislation is implemented, very soon there will be few if any telecommunications services that are not offered by competing companies

The regulated ratepayers have paid for the current public switched network. These same ratepayers are the potential customers for advanced telecommunications and video services in the future. In rural, or high cost areas, video choices for customers may be limited to one CATV company and possibly a DBS<sup>4</sup> provider. New competitors are not likely to enter these markets. The local LEC must not be excluded from entering new nonregulated businesses due to strenuous cost allocations that would be absorbed by the new business. Allocation rules should not create any false incentives or disincentives to invest and enter competitive markets.

## D - Fixed allocators are not flexible enough to provide reasonable results.

Usage based allocations are still a viable means for allocating costs. As with any system, the results must be reasonable. The inability of some current costing approaches to capture the essence of the investment and/or service is a well-cited problem. The inability of current and

<sup>&</sup>lt;sup>3</sup> NCTA Comments at p. 11

<sup>&</sup>lt;sup>4</sup> Direct Broadcast Satellite television service

previous cost allocation methods to handle technology changes under historical costing methods, (e.g., costing on voice equivalent circuits), should not be interpreted as requiring a completely new way of allocating costs. The current rules need to be evaluated and modified to incorporate the advancement of technology, capacity and services <sup>5</sup> To abandon the current system as a result of the cost identification problems inherent with this development would be an over reaction.

NCTA advocates a 75% allocation of costs to video services to ensure that LECs telephone ratepayers are able to share in economies of scope brought on by the use of integrated networks capable of video and telephone services. The current Part 64 rules, though not designed to provide such sharing of economies, are intended to provide a measured means for sharing costs. To the extent that the shared costs reflect certain economies achieved by the capabilities of the network, the economies of scope are essentially allocated between the nonregulated and regulated customers. The notion that one group of ratepayers should receive a larger share of these economies for some policy purpose is for the FCC to decide. The current price cap system has a built-in mechanism for discouraging cost shifts to regulated services. The price cap LEC cannot raise prices to recover any excessive cost shifts. Several commenters point out that the Commission's price cap system prevents such unreasonable allocations of cost. The control of the control of the commission of cost. The control of the commission of cost. The price cap system prevents such unreasonable allocations of cost.

The basis for the 75% factor, as provided by NCTA, demonstrates the difficulty in allocating costs under the industry accepted practice of "equivalent voice grade circuits". The capacity requirements of video and broadband services so much exceeds what is required for voice service that cost assignment anomalies can develop. The cost per unit of capacity for video and voice does not support the 75% figure advanced by NCTA. If it did then CATV rates would be extremely high industry wide. In fact, basic cable rates are generally not much higher than local phone rates, and in some cases less. The NCTA is correct in stating that the exact level of sharing of common costs is a policy decision for the FCC.

<sup>8</sup> NCTA Comments at p. 21

<sup>&</sup>lt;sup>5</sup> The historical approach of using voice grade equivalent circuits as an allocation mechanism needs to change recognizing the bandwidth requirements of certain services.

<sup>&</sup>lt;sup>6</sup> NCTA Comments at p. 20

<sup>&</sup>lt;sup>7</sup> Ameritech Comments at p. 5; BellSouth Communications at p. 5

We believe that the policy decision for sharing costs should not be tainted by the anomalies which currently reside in the cost allocation procedures in use today. And that the policy decision must recognize the variety of individual company circumstances related to current facilities in place, market share and size, and the ability to efficiently and competitively deliver services over the developing integrated networks. Under a competitive model, these individual situations are accounted for in the business decision to invest and provide services.

## E - NCTA proposal is not supported by the record and would not serve the public interest

NCTA and the cable companies are trying to employ this docket proceeding as a means to prevent, or at least handicap, competitive entry by LECs into video services. Competitive entry and the equitable rules to make it happen are one of the primary objectives of this proceeding. The fixed 75% allocation proposal and the arguments advanced which support it again demonstrate the arbitrary nature of cost allocations of this kind and the difficulty the FCC faces in balancing the competing interests participating in this proceeding. The endorsers of the fixed allocator approach are ignoring very fundamental characteristics of the industry as it stands today. Local exchange carriers provide ubiquitous telephone services. This has been possible through the adoption and enforcement of very specific accounting and costing rules which account for the vastly different service areas and markets for telephone service in the nation. NCTA, in fact, makes the point that cost determinants vary widely between LECs.<sup>9</sup> Yet in the same breath, NCTA argues that such differences should not lead to variance in cost allocation. This does not make sense. The nature of cost, technology, customer base, and difficulty to serve are the very reasons that cost allocation systems must be flexible enough to achieve reasonable competitive costing/pricing results.

## III - REQUIRED CHANGES TO PART 64

The rule changes contemplated by this docket will affect parties in different ways. Current and potential competitors of LECs will face new competitors in their business as LECs opt to enter the video services industry. LECs will make business decisions based on the new rules regarding entry into the video services business and investment in facilities directed at creating an integrated services network. Regulators will be saddled with new enforcement responsibilities to ensure adequate compliance with the

<sup>&</sup>lt;sup>9</sup> NCTA Comments at p. 11

rules and to monitor the impact of these rules on regulated rates. GVNW supports the positions of the LECs and urges the FCC to create Part 64 rule changes that will not preclude LECs from entering the new video and advanced telecommunications services markets

Part 64 rules must be modified to account for the challenges that technology and new services create when it comes to cost identification. As discussed above, the historical usage-based allocation procedures should not be discarded in favor of the flat allocator, but the "voice grade equivalent" basis for cost assignment will not work with high capacity and broadband services.

We recommend that the allocation of costs associated with loop plant recognize the actual demand for both the regulated and nonregulated services being provided. Actual demand and market conditions must also be recognized in allocation of spare facilities. Clearly, in an integrated network spare capacity will be an engineering necessity. To fairly allocate such spare capacity, or facilities, recognition must be given to relative demand. We believe that relative usage is the most fair and least speculative means for dealing with spare capacity and facilities. While the NCTA recommends careful review of such allocations to ensure telephone customers not subsidize video investment<sup>10</sup>, it fails to recognize that individual telephone company circumstances vary widely and a fixed allocator approach cannot accommodate such variances

GVNW believes that the current framework and operation of the Part 64 rules has achieved reasonable results. Part 64 requirements permits different cost allocations, by company, through the operation of individual company cost allocation manuals (CAM). It is through the inherent flexibility of individual company CAMS that LECs will be able to adequately address the concerns regarding cross-subsidization of services and promotion of competition brought up by this proceeding.

#### IV - CONCLUSION

For the reasons discussed in our initial comments and these reply comments, GVNW respectfully urges the FCC to adopt appropriate revisions to the current Part 64 rules to meet the objectives of this docket. The Commission should reject the proposals advanced by the cable industry to impede competition by

<sup>&</sup>lt;sup>10</sup> NCTA Comments at p. 22

exchange carriers. With the promotion of competition as a policy objective, any alleged advantage formerly regulated incumbent LECs had should not be used as logic for handicapping these companies' efforts to enter new markets, package services, and deliver what promises to be service, cost and competitive-choice benefits to customers. Proper economic signals and rational business decision making will be disrupted by the regulation proposed by the cable industry. The public interest will be served by creating fair allocation rules which do not arbitrarily advantage one market participant over another.

Respectfully submitted,

GVNW, INC./MANAGEMENT

DX7

Robert C. Caprice / Consulting Manager

7125 S.W. Hampton Portland, OR 97223 (503) 624-7075

June 12, 1996